TRIBHUVAN UNIVERSITY

2079

B.B.S. 4 Yrs. Prog. / II Year / MGMT

Fundamentals of Financial Management — Full Marks: 100

(MGT-215) (New Course) — Time: 3 hrs.

Candidates are required to give their answers in their own words as far as practicable.

The figures in the margin indicate full marks.

Group "A"

Brief Answer Questions [10×2=20]

Attempt ALL questions.

1. What are the functions of managerial finance?
2. How is perpetuity different from annuity?
3. In what situations should a firm consider the use of stock dividend?
4. List three advantages of net present value method over pay back method.
5. What are the motives for holding cash?
6. The cost of common stock is always higher than that of debt capital. Justify.
7. Sindhu Company has been procuring in a lot size of 1000 (EOQ) units, material cost per unit is Rs. 20, ordering cost is Rs. 100 and estimated holding cost is 20 percent of unit cost per unit. What is the annual requirement in units?
8. The Everest Trading Company has operating profit of Rs. 40,000, interest expenses of Rs. 6,000 and preferred dividend of Rs. 8,000. If it pays taxes at the rate of 25 percent, what is its financial BEP?
9. Stock Y has a beta of 1.45 and expected return of 17 percent. If the risk free rate is 6 percent and market risk premium is 7.5 percent Is the stock correctly priced?
10. The New Kanchan Company's current EPS is Rs. 6.50. It was Rs. 4.42 five years ago. What was the past growth rate in earnings?

Group "B"

Descriptive Answer Questions [5×10=50]

Attempt only FIVE questions.

11. How does wealth maximization goal overcome the drawbacks of profit maximization goal? [10]

12. The following data apply to Sagarmatha Company.

Cash and marketable securities	Rs. 10,000	Sales	Rs. 100,000
Fixed assets	Rs. 28,350	Net income	Rs. 5,000
Quick ratio	2.0×	Current ratio	3.0×
Days sales outstanding (DSO)	40 days	Return on equity (ROE)	12.0%

Calculation is based on 360 days. Sagarmatha has not issued any preferred stock.

a. Find Sagarmatha's current assets.

b. What are the limitations of ratio analysis? [6+4]

13. Assume that 1 year from now you plan to deposit Rs. 1,000 into a savings account that pays a nominal rate of 8 percent.

a. If the bank compounds interest annually, how much will you have in your account 4 years from now?

b. What would your balance be 4 years from now. If the bank used quarterly compounding rather than annual compounding?

c. Suppose you deposited the Rs. 1,000 in 4 payments of Rs. 250 each at the end of Years 1, 2, 3, and 4. How much would you have in your account at end of year 4, based on 8 percent annual compounding?

d. Suppose you deposited 4 equal payments in your account at the end of Years 1, 2, 3 and 4. Assuming an 8 percent interest rate, how large would each of your payments have to be for you to obtain the same ending balance as you calculated in part a? [4×2.5]

14. Everest Company's current stock price is Rs. 360 and its last dividend was Rs. 24. In view of company's strong financial position and its consequent low risk, its required rate of return is only 12 percent. If dividends are

expected to grow at a constant rate in the future, and if required rate of return on stock is expected to remain 12 percent, what is company's expected stock price 5 years from now? [10]

15. The small tool company was recently formed to manufacture a new product. The company has the following capital structure in the beginning of the year 2021.

13% Debenture of 2030	Rs. 6 million
8% Preference stock	Rs. 2 million
Common stock (80000 shares of Rs. 100)	Rs. 8 million
Total	Rs. 16 million

The common stock sells for Rs. 200 a share on this data. Last year company paid divided of Rs. 20 per share and expected to grow at the rate of 10 percent. The company has a marginal tax rate of 40 percent.

a. Compute the firm's weighted average cost of capital.

b. Is the figure computed in (a) is an appropriate acceptance criteria for evaluating new investment proposal? [8+2]

16. Lumbini Sugar Mills has degree of operating leverage (DOL) of 2 at its current production and sales level of 10,000 units. The resulting operating income figure is Rs. 1000.

a. If sales are expected to increase by 20 percent from the current 10,000 units sales position, what would be the resulting operating profit figures?

b. At the company's new sales position of 12,000 units, what is the firm's new DOL figure? [5+5]

$P_0 = D_1/k$

Group "C"

Analytical Answer Questions [2×15=30]

Attempt any TWO questions.

17. Why is the management of working capital important in a business? How does the good credit policy of a firm helps in management of working capital? Explain. [9+6]

18. Consider the probability distribution of alternative rates of return associated with stock A and B given in the following.

State of economy	Probability	Stock A	Stock B
1	0.3	-20%	5%
2	0.3	30%	25%
3	0.4	40	30

a. Calculate the expected return and standard deviation of Stock A and Stock B

b. What are the covariance and correlation coefficient between Stock A and Stock B?

c. If you form a portfolio of Stock A and Stock B comprising 70 percent wealth in Stock A and the rest in Stock B, calculate the risk and return of your portfolio. Are you able to diversify the risk forming the portfolio?

d. Covariance between stock B and market is 140 and standard deviation of market is 9 percent. If risk free rate is 6 percent and market risk premium is also 4 percent, calculate required rate of return on stock B. Is stock B overpriced or underpriced?

[6+3+3+3]

19. Generation X Ltd. has identified the following two mutually exclusive projects:

Year	Cash Flow (A)	Cash Flow (B)	
0	(Rs. 100,000)	(Rs. 100,000)	
1	35,000	45,000	450000
2	35,000	30,000	700000
3	35,000	40,000	120000
4	35,000	10,000	

Factor LR - True Factor
Factor LR - Factor HR

a. What is the internal rate of return for each of these projects? If you apply the IRR decision rule, which project should the company accept? Is this decision necessarily correct?

b. If the required return is 11 percent, what is the NPV for each of these projects? Which project will you choose if you apply the NPV decision rule?

c. If there were a conflict between IRR and NPV decision rules, how would you choose the project?

d. Why the projects become mutually exclusive? [6+6+2+1]